

Prime Minister (2)

9 July 1982

Policy Unit

PRIME MINISTER

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THE MEGAW REPORT

We have now studied this Report, and you may find it helpful to have our reactions to it. In general, we do not think it is a particularly good Report; it is not as helpful to the Government as the press has made out, and it will not be at all easy - perhaps not even desirable - to construct an orderly and agreed Civil Service pay determination system upon it.

There are parts of the Report which, because they endorse our general approach to public service pay, can be used to our advantage; and the adverse reaction of the unions may make it easier for us to avoid the pitfalls. Above all, we want to write up in letters of gold the fact that the first major enquiry into Civil Service pay in 25 years has recommended that:

". . . the governing principle for the Civil Service pay system in the future should be to ensure that the Government as an employer pays civil servants enough, taking one year with another, to recruit, retain and motivate them to perform efficiently the duties required of them at an appropriate level of competence." (Paragraph 91)

Our overall public service pay policy is endorsed in three important respects: the replacement of comparability by market factors (paragraphs 78 and 91); the need to relate pay to performance and to develop the management skills to do so (paragraphs 329 and 351); and the desirability of removing the right of unilateral access to arbitration (paragraph 270). The Report is also helpful in stressing that job security ought to be taken into account and that civil servants' pension contributions should cover the whole of the employees' share of pension costs.

But there is a central flaw: the failure to carry the principle of market factors through into a workable, non-comparability-based method of pay determination. The proposed Pay Information Board (PIB), replacing the old Pay Research Unit, would certainly operate in some respects in an improved fashion - by using outside consultants, eliminating public sector analogues, and including small firms which generally pay less. But its product would be two iron limits (the

"interquartile range"), based solely on comparability, not themselves subject to negotiation, within which negotiations would take place. Megaw justifies this in a revealing passage - paragraphs 101 and 102 - which seem to say that market factors and comparability would produce the same result anyway, which is nonsense. Fair comparison is constantly creeping back in.

So the main principles which the Government is seeking to incorporate become relegated to the status of factors to be "taken into account" in deciding where, within the interquartile range, the settlement will lie. By paragraph 208, all these factors have become merely "an aid to discussions within the framework of collective bargaining". There is no provision for trying to establish them exogenously, or to incorporate them into the judgment of what is to constitute the interquartile range. And this failure is compounded by two further weaknesses: the provision for the PIB to use percentage pay increases rather than pay levels in its comparisons (this is bound to focus attention more sharply on comparability than on market factors); and the provision for a four-yearly review of pay levels, which will provide the opportunity for catching up.

Whether all this can work depends largely on whether the interquartile range is likely to be wide enough to allow genuine negotiation on the basis of recruitment and retention factors. Officials need to study past experience to discover the answer. Even if the range is reasonably wide - Megaw instances a range of 4-8% - there is still a danger that, in the actual negotiations, we would argue strongly for the bottom figure, and the unions would, equally strongly, insist on the top figure, with no agreed basis for the argument; and that every four years there would be a gigantic catching-up exercise. There is therefore a risk that Megaw would turn out to have recommended three years of Priestley followed by a fourth year of Clegg. Indeed, in paragraphs 368-370, in their response to the minority report, the majority are virtually reassuring Mr Chalmers that their recommendations would not fundamentally alter the Priestley system.

Nor is the Report any more helpful over affordability. As elsewhere, the difficulties which were exposed in the Government's evidence, and which the Inquiry team was invited to resolve, are simply repeated with the conclusion that they should be "taken into account". But even the little the Inquiry does say is unsatisfactory. The

Government evidence made it clear that any new arrangements should have adequate regard to the Government's duty to control public expenditure, and manage the economy in the interests of the population as a whole; the Inquiry's response (paragraphs 217 and 218) is that the Government should build realistic assumptions into its cash limits, but avoid making them explicit - in other words, the Government should react to and accommodate current pay trends, and it should not attempt to impose pay rates which are no higher than what can be afforded.

So we doubt if the Megaw recommendations offer a satisfactory basis for a system to replace Priestley. Officials should certainly study them in good faith to see to what extent they can be made to work, consistent with our policy; and there may well be tactical advantage in letting the unions make their running in criticism of the Report. There is something to be said for having a Pay Information Board as an advisory research bureau - better still if it is to research into recruitment and retention rates inside the Civil Service as well as on pay outside the Civil Service. If the PIB's findings in both areas were agreed as a statistical basis, that might well provide a helpful background for negotiations.

But we think the Report raises a major question which the Inquiry team has not addressed at all: whether we do in fact wish to have a new Pay Agreement. Our evidence made much of the desire for "ordered and agreed arrangements", but we have not done too badly this year without them. It is perfectly feasible to envisage a pay determination system in which the only structure is that the union puts in a claim, and the Government makes an offer, and both sides then bargain. Each side would be free to use whatever evidence it wanted, and the only agreement that would be needed would be on the resolution of disputes, where the Megaw arbitration proposals could be incorporated. That may turn out to be a more attractive option than trying to force the Megaw Report into a shape that is mutually acceptable to us and to the unions.

I am sending a copy of this note to the Chancellor of the Exchequer and to Sir Robert Armstrong.

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